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BEFORE THE ARIZONA CORPORATION (

Arizona Corporation Commission
DOCKETED
JUN 20 2008
DOCKETED BY

COMMISSIONERS
MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTIES THROUGHOUT ARIZONA.

DOCKET NO. G-01551A-07-0504

NOTICE OF FILING OF TESTIMONY SUMMARIES

Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony Summaries of Staff Witnesses Robert G. Gray, Phillip S. Teumim, David C. Parcell, Stephen L. Thumb, Rita R. Beale, and Corky Hansen, on behalf of the Utilities Division, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 20th day of June, 2008.

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Original and thirteen (13) copies of the foregoing filed this 20th day of June 2008 with:

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Arizona Corporation Commission
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Phoenix, Arizona 85007

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SUMMARY OF TESTIMONY
ROBERT G. GRAY
EXECUTIVE CONSULTANT III
ON BEHALF OF UTILITIES DIVISION STAFF
DOCKET NO. G-01551A-07-0504
June 20, 2008

My testimony addresses issues related to the purchased gas adjustor mechanism. My testimony contains the following recommendations:

1. The bandwidth on the monthly PGA rate should be expanded to $.015 per therm.

2. The threshold on the PGA bank balance for undercollected balances should be eliminated.

3. The threshold on the PGA bank balance for overcollected balances should be set at $55.78 million.

4. If the rate design revenue decoupling proposal is adopted, before it is implemented, Southwest must develop, and receive Commission approval of, a revised PGA mechanism that addresses the changes in the calculation of the PGA and related issues. Further, if a rate design revenue decoupling mechanism is adopted in this case, Southwest should review its monthly PGA report and work with Staff to adjust the report as necessary to reflect changes resulting from revenue decoupling.

SUMMARY OF TESTIMONY
PHILLIP S. TEUMIM
ON BEHALF OF UTILITIES DIVISION STAFF
DOCKET NO. G-01551A-07-0504
June 20, 2008

My testimony contains the following recommendations:

1. Southwest Gas should examine its construction, engineering and other processes associated with customer growth to determine whether and to what extent costs associated with those processes may be reduced.

2. In its next rate proceeding, Southwest Gas should be required to demonstrate that its line extension fee is being implemented properly.

3. In its next rate filing, the Company should demonstrate how its policies and procedures comport with the results of the Hookup Fee proceeding.

4. Consideration should be given to allowing for an increase in total R&D funding based upon freezing the per therm charge to customers at the initial rate of $0.00113.

5. Southwest Gas should consider R&D projects directed toward reducing the cost of new construction.

6. The Company should track and report additional information about its DSM programs, including "hard dollar" cost-benefit analyses and payback periods.

7. The Commission should allow for an increase in the approved funding level for cost-effective programs above the $4.4 million per year level, at levels of $5.4, $6.4, and $7.4 million for 2010, 2011, and 2012, respectively.

SUMMARY OF TESTIMONY
DAVID C. PARCELL
TECHNICAL ASSOCIATES, INC.
ON BEHALF OF UTILITIES DIVISION STAFF
DOCKET NO. G-01551A-07-0504
June 20, 2008

My testimony addresses the total cost of capital for Southwest Gas.

Recommended Cost of Capital

My overall cost of capital recommendations for Southwest Gas are:

	Percent	Cost	Return
Short-Term Debt	0.00%	N/A	N/A
Long-Term Debt	52.08%	7.96%	4.15%
Preferred Stock	4.48%	8.20%	0.37%
Common Equity	43.44%	9.3-10.5%	4.13-4.56%
Total	100.00%		8.55-9.07%
		8.86% with 10.0% ROE	

Southwest Gas' application requests a return on common equity of 11.25 percent and a total cost of capital of 9.45 percent. This cost of capital is based on a hypothetical capital structure comprised of 51 percent long-term debt, 4 percent preferred stock, and 45 percent common equity.

Summary of Cost of Capital Analyses

This proceeding is concerned with Southwest Gas' regulated natural gas utility operations in Arizona. My analyses are concerned with the Company's total cost of capital. The first step in performing these analyses is the development of the appropriate capital structure. Southwest Gas' proposed capital structure is the "target" capital structure ratios of the Company, which is actually a hypothetical capital structure. I do not use this hypothetical capital structure in my cost of capital analyses, but rather use the Company's actual test period capital structure ratios.

The second step in a cost of capital calculation is a determination of the embedded cost rates of long-term debt and preferred stock. I have used a 7.96 percent cost for long-term debt and a 8.20 percent cost rate for preferred stock, both of which are contained in Southwest Gas' application.

The third step in the cost of capital calculation is the estimation of the cost of common equity. I have employed three recognized methodologies to estimate the cost of equity for Southwest Gas. Each of these methodologies is applied to two groups of proxy utilities. These three methodologies and my findings are:

	Range	
Methodology	Direct Testimony	Surrebuttal Testimony
Discounted Cash Flow	9.3-10.4%	9.5-10.6%
Capital Asset Pricing Model	9.5-9.8%	9.4-9.6%
Comparable Earnings	10.0-10.5%	10.0-10.5%

Based upon these findings, I conclude that the cost of common equity for the proxy utilities is within a range of 9.3 percent to 10.5 percent (9.9 percent mid-point). This range is determined by the results of all three of my cost of equity methodology results, since all three sets of results fall within this range. I recommend that Southwest Gas' cost of equity be slightly above the 9.9 percent mid-point of my range or 10.0 percent. I recommend a slightly higher cost of equity in order to recognize the impact of Southwest Gas' lower equity ratio and debt ratings, relative to those of the proxy groups.

Combining the capital structure and individual cost rates, results in a weighted cost of capital for Southwest Gas. My recommended overall cost of capital range is 8.55 percent to 9.07 percent (8.86 percent with 10.0 percent cost of equity). I recommend an 8.86 percent cost of capital for Southwest Gas.

SUMMARY OF TESTIMONY
STEPHEN L. THUMB
ON BEHALF OF UTILITIES DIVISION STAFF
DOCKET NO. G-01551A-07-0504
June 20, 2008

My findings are as follows:

- The El Paso Natural Gas (EPNG) pipeline tariff (i.e., EPNG tariff effective January 1, 2006, subject to revision) enacted during this time frame represented a total and complete restructuring of interstate pipeline services for SW Gas. This single event appears to have had an impact on nearly every phase of SW Gas' operations during the audit period. It is difficult to note succinctly the enormity of this change and its impact on SW Gas. In very simplified terms the EPNG system for East of California was converted from a (1) full requirements concept that provided swing services to (b) a system that, in essence, provided no swing services.

- As a result of this new EPNG tariff, the annual fixed charges paid by SW Gas for interstate pipeline capacity did increase appreciably. Subsequently, after extensive efforts by SW Gas and the other East of California customers, the EPNG rates for the various transportation services were reduced from EPNG's initial proposal, such that SW Gas' fixed annual transportation costs did not double, but it did increase about 60 percent.

- SW Gas under this new EPNG tariff did incur additional charges and penalties, but the incursion of these additional charges and penalties appears to be reasonable. Under the new EPNG tariff it is nearly impossible to operate without incurring some additional charges and penalties. At the beginning the optimum economic trade-off between the cost of pipeline services and minimization of additional charges and penalties was probably not knowable. Subsequently SW Gas took a very proactive role in attempting to minimize additional charges and penalties.

My recommendations are as follows:

(1) SW Gas is attempting to diversify its interstate pipeline capacity portfolio and SW Gas should continue seeking access to storage capacity, particularly market-area storage capacity.

(2) SW Gas should increase the supply documentation and requirements for its transportation-only (T-1) customers.

(3) SW Gas should make its Daily Forecasting Accuracy Improvement Task Force a permanent entity. SW Gas' policies should also require ongoing validation and back-testing of its daily load forecast, along with its required frequency.

(4) Until the point that market-area storage becomes a reality in Arizona, it is recommended that SWG work with other Arizona utilities and the Commission Staff to develop and implement policies that would promote the sharing of gas supplies among the major users of interstate pipeline capacity in Arizona during extreme conditions.

(5) While SW Gas has taken efforts to diversify its future pipeline capacity portfolio, it is recommended that SW Gas carefully track the likelihood of LNG imports entering the Southwest gas market and consider gaining access to such supplies, in an effort to diversify its gas supplies and reduce its dependence on the San Juan basin.

In my review of SW Gas' gas supply portfolio and related practices for the audit period covering September 2004 through April 2007, I concluded:

- Southwest's gas supply strategies were prudent and reasonable.

- Its gas supply strategies were effective at providing firmness of supply, providing price stability, and reducing price volatility, main objectives of SW Gas' Arizona Price Stabilization Plan.

- The gas supply transactions executed and prices paid were reasonable and prudent.

- The price indices used by SW Gas in setting their natural gas purchase prices are standard industry indexes with good market liquidity.

- EVA is not concerned that SW Gas may rely on NYMEX based pricing, as this is the leading price benchmark of the U.S. natural gas industry, and it cannot be avoided. Furthermore it should continue to be at Southwest's discretion, whether it locks fixed prices for the APSP in either one or two transactional components.

- While it would be to the benefit of all market participants to have a larger number of transactions reported to industry publications, thereby increasing liquidity of the published price indices and theoretically increasing their reliability, each company must be responsible to determine its own comfort level and ascertain its risks and rewards before participating in the sharing of its confidential information. Participation is not a trivial matter in today's litigious world.

- Any decision by the ACC to require utilities to report transaction data to industry publications could also have unintended consequences, and thus should be carefully examined before mandating participation. If the ACC decided to require Arizona regulated gas utilities to participate, for fairness reasons and to level the playing field, it would be important to also require regulated electric utilities to report as well.

- Many of SW Gas company policies, procedures, and strategies are insufficiently documented in official company documents. While the concepts embedded in SW Gas' policies, procedures, and strategies appear reasonable and prudent,

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curiously one must tend to go to the documents submitted by SW Gas to the Arizona Corporation Commission to find the most complete picture of company policies, procedures, and strategies. In addition, some policies, procedures, and strategies fall short in certain areas by their lack of documented official position on certain subjects.

- The Monthly Bank Balance Statements compare well to the base transactional data of the GTS, with the exception of the month of January 2007 when SW Gas under-scheduled gas commodity by 356,000 mmBtu and SW Gas paid a premium over market prices to El Paso Natural Gas of some $400,000. A number of changes to the El Paso tariff, the Southwest Gas tariff, and proactive actions by SW Gas, discussed in detail in Exhibit RRB-2 Chapter 3 Section on Bank Balance Statements, suggest that a similar scenario is highly unlikely to be repeated in the future. A repeat of such a large cash-out penalty in the future might be very well be viewed as imprudent given SW Gas' climb up the learning curve since the introduction and implementation of El Paso's new tariffs during 2006 and 2007. Still SW Gas should continue to press EPNG to improve the quality of its 'real time' load estimates that it broadcasts to shippers via EPNG's Electronic Bulletin Board.

- SW Gas did a good job of following its policies and procedures based on an audit of selected transactions described in detail in Chapter 3 of Exhibit RRB-2.

The two management recommendations rejected by SW Gas are:

In my review of SW Gas' gas policies and procedures, I generally concluded that many of SW Gas company policies, procedures, and strategies are insufficiently documented.

- Consolidate all strategies, policies, and procedures into a minimal number of official company documents with sufficient detail such that new employees could read them and perform the bulk of their work. Staff wants SWG to work toward attaining Industry Best Practices to enhance the culture of managing risk inside SWG. <u>This increases in importance as SWG begins to use derivative instruments in 2008.</u> SWG has gaps in documenting its strategies, policies, and procedures for physical procurement of physical natural gas and SWG has accepted eight other Staff recommendations. Staff wants SWG to centralize these new and all existing documents internally to the extent possible. A docket search is not an appropriate way for employees to locate company policies, etc. In fact, some documents or topics may be more sensitive than others and may be necessary to consider as confidential and not file annually with the Commission. Also it is not appropriate to rely on externally authored reports (e.g., Ralph Miller July 2006) to describe official SWG strategies (which appear to be evolving over time) to SWG employees. Having strategies and policies spelled out does not diminish one's level of professionalism; it may enhance it. This can also be an effective tool to help orient new employees.

- In my surrebuttal, this recommendation was amended to generically note that SWG needs to create an acceptable Limits and Controls document. SWG rejected the suggestion in my direct testimony that the monthly "Arizona Dispatch Guideline" is appropriate and Staff does not believe the "Department and Staff Responsibilities-Portfolio Selection Procedures" is appropriate as suggested by SW Gas. Because of our disagreement, I now simply recommend to create a new document that conforms to Industry Best Practices. Also SWG does not agree that the Board of Directors need to authorize the Limits and Controls document or to be involved, which is contrary to Industry Best Practices. Limits and controls represent the mechanism by which a firm's risk appetite is articulated and communicated to different constituencies – senior management, business line management, traders and other risk takers, risk managers and operations personnel. This is a formal statement of the allowable commodities, instruments, quantities, markets, and levels of trader authorization by quantity or value, etc., as authorized by the Board of Directors according to Industry Best Practices.

The eight management recommendations rejected by SW Gas are:

- Clarify supply element of the Arizona Price Stability Purchases by documenting expected volumes and timing for the next one to two years forward.

- Clarify the precise nature of the Arizona Price Stability Purchases strategy. Is it a programmatic hedge, a judgmental hedge, or a hybrid of the two? The precise strategy should be recognized and declared in company policies and procedures to guide employees and decision makers, as well as the ACC's oversight.

- Company policies regarding the 'unbuying' of gas, as well as the reasons for the policies, should be reevaluated, and then explicitly documented in official company policies and procedures.

- Ensure all confirmations with gas suppliers, also known as Exhibit A, include deal transaction dates.

- Ensure all confirmations with suppliers, also known as Exhibit A, include dates of the internal approval next to authorized signature.

- Considerably shorten the time lapsed between deal execution and deal confirmation with gas suppliers.

- Include a list of attendees present during the solicitation and purchase of the APSP fixed price gas supply element (as well during selection and approval of the index gas supply element) to ensure independence, proper monitoring, and to improve the quality of the audit trail.

- A review of the liquidated damages terms was found to be acceptable.

SUMMARY OF TESTIMONY
CORKY HANSON
ON BEHALF OF UTILITIES DIVISION STAFF
DOCKET NO. G-01551A-07-0504
June 20, 2008

My testimony contains the following recommendations:

1. The disallowance of all monies associated with the replacement cost of the Yuma Manors subdivision gas distribution system.